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THE MARKET: The accompanying news clip from the Wall Street Journal might well provide the background for 1967. Just as 1966 proved a case of too many wanting too much in the money markets, 1967 appears to be shaping up as a repeat performance of 1966— and then some. The "then some" is going to come from the U.S. Government, which is in the process of running its expenses into the stratosphere. For a second time this year, Congress is to be asked to raise the national debt ceiling (this time to over $340 billions). Thus, the debt "ceiling" does not resemble a ceiling at all; it really looks more like a "stairway to the stars."

Long-Term Treasurys Near or at '67 Lows; Declines Range to 12-32

Investment Grade Corporates in Secondary Market Are Heavy Losers; Tax-Exempts Also Off

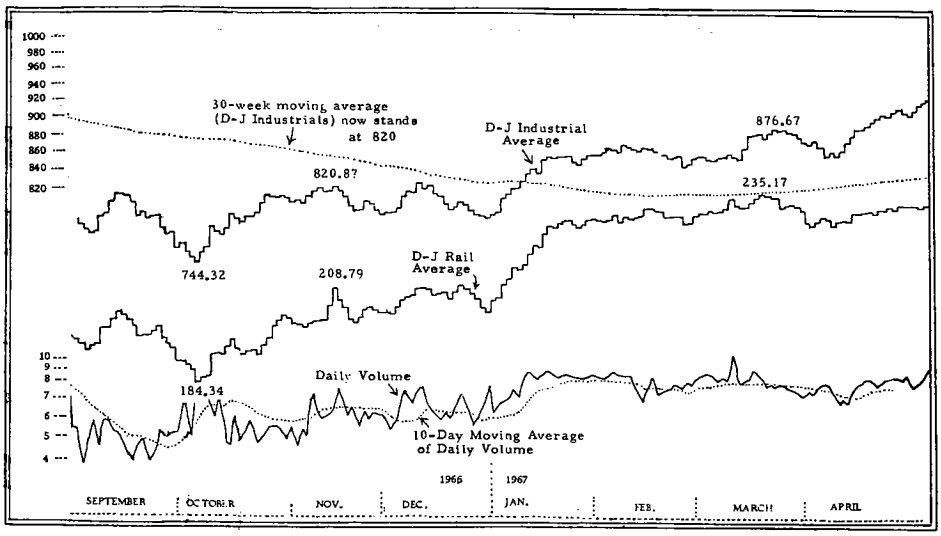
By a WALL STREET JOURNAL *Staff Reporter*

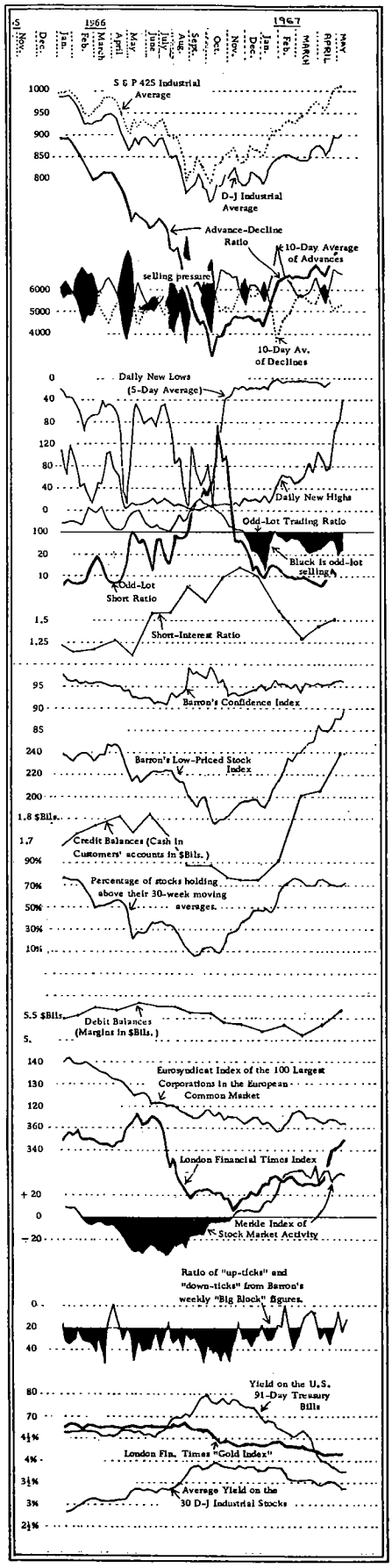
NEW YORK — Long-term U.S. Government bond prices continued a weeks-long tailspin and closed yesterday at or near their 1967 lows.

Investment-grade corporate bonds trading in the secondary market also took heavy losses amounting to between ½ and ⅝ point.

From all points borrowers, states, cities, individuals, corporations, are poised to enter the money market again. The corporate picture is particularly ominous, with corporate liquidity at uncomfortably low levels. In a study of 90 leading corporations during 1965 and 1966, Forbes Magazine comments that 1966 saw "....a money stampede that would have done justice to a herd of thirsty cattle." Why the rush to the money markets? The answer is that corporations were non-liquid; holdings of cash and marketable securities were down; inventories, long-term debt and receivables were up. I took an average of the 90 corporations and found that the ratio of cash and marketable securities to total liabilities dropped from 68% in 1965 to 57% in 1966!

New corporate borrowings in 1966 rocketed to a record $12 billions, bringing total outstanding corporate debt to an all-time high of $220 billions. Corporate borrowings for the first quarter of 1967 appear to have surpassed first quarter 1966 already. U.S. corporations must now deal with acceleration of tax payments in the face of lower profits (profits are perhaps 10% lower so far in 1967). Furthermore, inventories and receivables are holding at extremely high levels. This is going to mean one thing— money, money and more money will be needed. All of this is going to be reflected in the bond markets as the new "stampede for money" goes into high gear.




1966
1967
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio
10-Day Average of Advances
selling pressure
10-Day Av. of Declines
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Block is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
Ratio of "up-ticks" and "down-ticks" from Barron's weekly "Big Block" figures.
Yield on the U.S. 91-Day Treasury Bills
London Fin. Times "Gold Index"
Average Yield on the 30 D-J Industrial Stocks

How will the stock market react to another potential crisis in the money markets? It seems to me that the writing is on the wall; anyone with imagination can now see at least the outline of what is ahead for money. Therefore, I feel that the security indices are now weighing the implications of the money picture, and the more sophisticated the index or average, the better the chances that the money story is being appraised correctly.

The D-J 40-Bond Index touched a peak of 83.56 on January 30. It has just traced a large downward zig-zag and is therefore in a definite downtrend (the Bond Average is now back to its early January, 1967 level). This is one of the most sophisticated barometers of investment sentiment.

On the N.Y.S.E., the D-J Utility Average has been laggard. Utilities recorded a high of 139.94 on January 19. On April 20 the Utilities pushed to 140.43, just 49¢ above their January level. By last week the Utilities had turned down, and they were again below their January peak. Essentially then, the sophisticated 40-Bond and D-J Utility Averages have refused to get into the act during 1967.

NOTES & QUOTES: Subscribers who have pooh-poohed my two-year series of warnings regarding Vietnam have lapsed into silence. All pretenses of negotiations and peace talks have now ended. The war appears to be at the stage where it is expanding out of control. Suddenly all eyes are turning to Moscow. There is an air of impending crisis in Washington. General Westmoreland has asked for 50,000 more men, and he is going to get them. The cost of the war is going to rise from $3 to 3.5 billions per month. The cost of 50,000 additional men in Vietnam is estimated at an additional $4 to $6 billions annually.

Russian-built MIGs are taking to the air in increasing numbers. U.S. combat plane casualties are moving above 525 planes lost, while accidental and other casualties (not published) are estimated at perhaps twice as high. The cost of the war is moving into the stratosphere. But more ominous, the U.S. is moving nearer and nearer direct confrontation with Peking and Moscow.

There is now talk of Hanoi moving its MIGs to Chinese airfields. There is talk of stepped-up Russian supplies of weapons to North Vietnam. With them will come more sophisticated weapons and greater U.S. plane casualties. What if the U.S. is temped to bomb Chinese airfields? What if the U.S. is tempted to bomb Russian shipping?

"Whatever the assumptions upon which Johnson and his close advisers now are acting," writes Tom Wicker in April 27's New York Times, "they are tripping along a tightrope over disaster and it is not even clear that if they reach the other end the journey will have been worth it."

I feel that President Johnson is banking on a primary thesis, that come what may, Russia does not want to get drawn into a war with the U.S. I think that thesis is correct. Therefore, LBJ is deliberately expanding the war to the point where even Russia will hesitate to "play the escalation game." The hope is that Russia will suddenly realize that the world is on the edge of the brink and (as happened at the Cuban confrontation) draw back and produce a typical "cold war settlement."

I believe the President is going to be mistaken. First, China would never allow such a settlement. China has all along considered that the U.S. will tire of the war or pull back rather than start World War III. Russia could cut off arms to Vietnam, but to do so would open her to Chinese charges of capitulating to the U.S. Second, Russia knows that the U.S. is as anxious as is Russia to avoid a direct confrontation. Therefore, Russia can play hero with the Communist world via arms shipments while continuing to stay in the background as far as the U.S. is concerned.

Finally, the ace-in-the-hole is the possibility nobody wants to talk about, the possibility that the Communists will start another Vietnam somewhere else in the world. Some months ago my friend Elliot Janeway opined that the new Vietnam could be Greece. I thoroughly agree with him. Such a new front would put enormous new financial and psychological pressures on the Free World. The communists are betting that if the tree is rocked enough, the trunk may split.

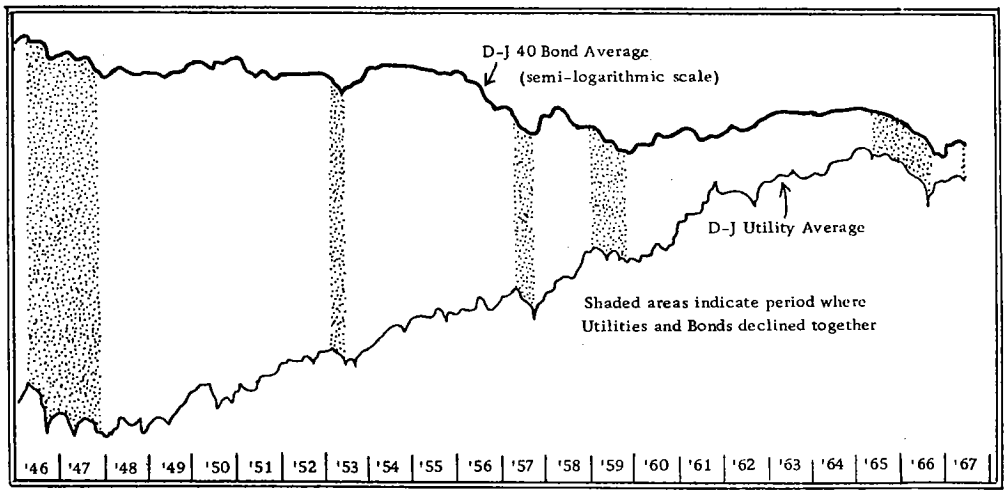
Long ago I wrote that I felt that when a man starts with a wrong set of premises, whether in business, economics, or politics, and he follows those premises to their logical conclusion, his policies will end in disaster. I stated that I felt that President Johnson's premises about Vietnam were wrong; I still believe they are wrong. LBJ is not a man who deals in nuances or sophisticated theory, he is a man who makes up his mind and once having made up his mind does not change it. Given the wrong premises, given a man of LBJ's stubbornness and self-rightousness, we have the formula for disaster. So far, as far as this observer can see, we are right on course.

The Rail Average (see Last Letter) struck a 1967 recovery high of 235.17 on March 17. Almost 7 weeks passed with Rails failing to better their March high. Then on May 5 the Rail Average jumped 3.72 points, closing at 235.87. By so doing, Rails confirmed the series of new Industrial recovery highs;both D-J components are now in new high ground for 1967, and the technical obstruction of continued Rail non-confirmations is now removed.

Here is what I will be watching in the period ahead: (1) the definite downtrend in the D-J 40-Bond Average, (2) the sluggishness of the Utility Average, (3) the trend of Industrials and Rails with particular emphasis on whether the new Rail confirmation is followed by general strength, or whether the Rail confirmation represents one of those "tail-end" run-ups that has (in the past) proved so deceptive in bear markets.

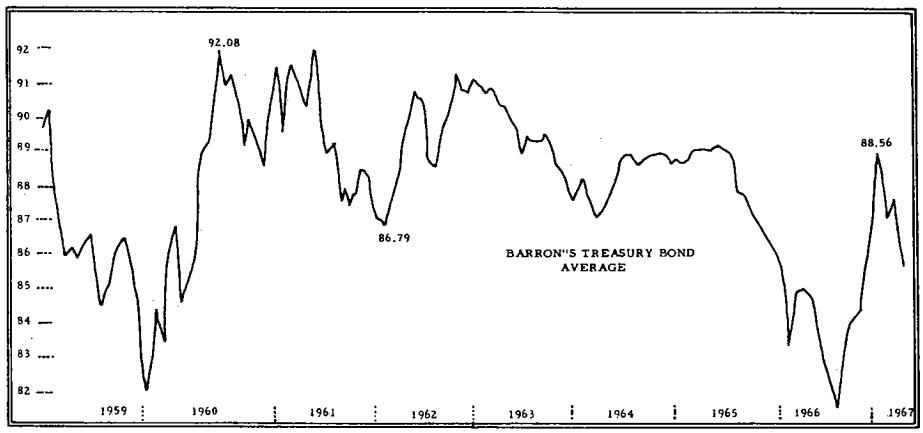
Conclusion: I view the entire movement since the October, 1966 lows as a major correction in a primary bear market. When the correction is over, the bear forces will take hold again. Therefore, it is of great importance to try to identify the ebbing and ultimate expiration of the bullish speculative elements which have been driving this market upward for the past six months. When the speculation and froth is over, reality is going to assume command. In the end, the bear will have his way. I urge all my subscribers who have not already done so to move into a protected position (as liquid as possible with the bulk of assets in 91-day Treasury bills). The background or tidal force in this market continues to be bearish. During this current second phase of the bear market we have expected the unexpected to occur— and it has. The investment world has turned bullish again, even though none of 1966's problems have been solved, and even though many of the monetary problems of 1966 are likely to be repeated again (probably with greater severity than was the case in 1966). But the bear has produced his illusion, the public and many high-flying funds have been sucked into the vortex of this speculative, explosive correction. The crowd and the investment fraternity are now greedy or shall we say "performance" minded. I urge my readers to forget greed and "quick riches" during this rally. Patience is still the scarcest commodity on Wall Street. But it is going to pay off in the end.

UTILITIES AND BONDS: Back in Letter 314 (February 10, 1966) I presented the accompanying chart study of the trend of the D-J Utility Average and the D-J 40-Bond Average. I stated in that Letter that "....whenever monetary forces are powerful enough to cause a pronounced decline in both Utilities and Bonds, such action serves as an advance warning for the entire market."


D-J 40 Bond Average
(semi-logarithmic scale)
D-J Utility Average
Shaded areas indicate period where
Utilities and Bonds declined together
'46 '47 '48 '49 '50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63 '64 '65 '66 '67

The chart shows five areas in which both Utilities and Bonds were in simultaneous downtrends. Each of these preceded or were accompanied by downtrends in the stock market. The five areas (shaded on chart) were 1946, 1953, 1957, 1959 and 1965-66. At present, the 40-Bond Index is again in a pronounced decline, while the Utilities (see previous discussion) are "rounding over" from their April 20 peak. I believe that this is the beginning of the next shaded portion of the chart, and it should serve, as it has in the past, as a warning of forthcoming trouble in the stock market.

MORE ON BONDS: In the last Letter I directed subscribers to watch the bond market from here on. For although Federal Reserve operations have driven the 91-day Bill rates down under 4%, the bond market has not responded. Quite the contrary as can be seen on the accompanying chart. This chart of Barron's Treasury Bonds is now worth studying carefully.



First we note the damaging effects of tight money in 1959; then the powerful recovery through 1960 as the Federal Reserve succeeded in taking the Treasury Bond Index (TBI) to a peak of 92.08 in August, 1960. In late-1961 as money tightened again the TBI dropped rapidly, finally halting at a February, 1962 low of 86.79. Another bond recovery (against a background of collapsing stock prices) carried into late-1962.

From late-1962 on, it was a matter of an almost steadily sagging bond market. During 1966 the drop became precipitous with the TBI breaking below 82 in October, 1966. Following almost chaotic conditions in the bond markets, the Fed "opened the faucets" and a most violent bond recovery followed. That recovery topped at 88.56 in February, 1967. The drop since then (although few realize it) has been almost as rapid as had been the advance. By late April the TBI broke below its January 3 price of 86.33 and sank to a new 1967 low.

Thus the TBI is again below its lows of 1962 (86.79) and 1964. The rally of 1967 appears to have lacked both strength and lasting power. I do not expect many more weeks to go by before news of bonds hits the financial headlines again. Against a background of rising war costs, rising city, state and Government costs, the next worst thing that could now happen to the bond market would be a marked recovery in business. That is something for the stock market to ponder.

In closing this bond section I want to insert a few paragraphs just received from Mr. A.J. Gilardi of Seattle, Washington. Few people realize how fantastically "out-of-kilter" the current stock-bond yield relationship is. It is a relationship predicated on inflation, printing press money and a continuation of favorable market conditions. I believe this bond-stock yield relationship and the conditions upon which it is predicated are going to change drastically in the several years ahead.

 "Some of your recent Letters suggest watching the DJ 40 bonds and interest rates; I used to keep track of them, but switched to the S&P series since 1960. The yield spread between the High Grade Corp. Bonds and the 425 Industrial stocks is of special importance, as you know only too well. Its fluctuations since Jan. 1, 1960 are given below:

Minus 1.66	9 Aug, 6 Sep and 13 Dec. 1961
Minus 0.43	27 June 1962
Minus 1.88	9 Feb. 1966
Minus 1.95	20 Apr. 1966
Minus 1.59	5 Oct. 1966
Minus 2.19	26 April 1967

"A comparison of the current figure with Feb. 1966 and the December 1961 leaves no doubt in my mind as how dangerous the situation really is."

COMMENTS: As I read dozens of financial and general interest publications one viewpoint comes in loud and clear—from all accounts the economy is to start expanding and we are to be in a new boom by the end of the year. This may be so, but primary bear markets have a habit of fooling just about everyone, and I am wondering whether a mighty big fooler is not on the way now. Debts are rising, bankruptcies are still running at very high levels. Everyone and his brother is preparing to come into the money market for more cash, taxes are rising, labor strife is forcing higher wages, and with it all the public is in a state of euphoria.

Against all the glowing reports I note a few discordant facts. (1) In April the number of Purchasing Agents reporting increased orders and stepped-up production was lower than those reporting declines. The Purchasing Agents Committee noted that in every postwar expansion when this occurred, the nation went into recession within 3 to 8 months. (2) Of the 36 "leading indicators" pictured in the Government's publication, Business Cycle Developments, almost two-thirds are still pointing down. Of the 36 leaders, 12 have been labeled most accurate, and of these 12, 9 are still bearish. This prompted George Shea of the Wall Street Journal to write on May 8, "In spite of widespread claims that general business is going to start a new upsurge July 1 or a few days after that, the economic indicators.....show little evidence to support such a belief."

From another standpoint I note that since January 1, almost 900,000,000 shares have been traded on the N.Y.S.E. Volume on the more speculative Amex has been running around 40% of N.Y.S.E. volume ("normal" is around 10% to 15%). The N.Y.S.E. volume is of record proportions, and I believe the Amex volume is as well. I feel that we are seeing a giant distribution area, with the public coming in "with both feet" and the market "churning" at a rate never before seen.

Here is what I mean. Last week the advance-decline line moved up each of the five days to the tune of 54.7 million shares total volume. Yet the pluralities of advance on the five days were 60, 112, 129, 119 and 60 or an average of 91 more issues per day advancing (over declines). This is churning as far as I am concerned, particularly in view of the near-record volume. Bear markets deal in deception and surprises, and this is particularly true during the second phase. I warn subscribers to get ready for surprises ahead.

LATE NOTES: The latest spread (May 8) in yields between S & P's AAA Bond Index and the 425 Industrial Average is 2.27% in favor of bonds. This is the highest yield spread in favor of high grade bonds in history. The situation is highly dangerous, and I feel that with this historic spread, informed distribution must be going on. I want to remind readers that Dow's Theory was based primarily on values. Dow advised investors to buy great values during periods of depression. He suggested holding those values until such times as boom conditions appear. At present common stocks in relation to top-grade bonds are the poorest values in history. In time, as sure as night follows day, this will change.

* * * *

Last week 147 blocks of 10,000 shares or more changed hands on the N.Y.S.E. This is near a record. Many funds are now trading and speculating like old-time "traders." The concept of investing in values is "out the window." In the past when this type of thinking was accepted by institutions, it has meant trouble.

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Latest information is that LBJ is now listening to the military on conduct of the war. The "whiz kids" are being downgraded. There is going to be a scapegoat needed, however, and all indications point to Mr. McNamara for that job.....The latest information points to a massive build-up by Russia to counter-act U.S. expansion of the war in Vietnam. Russia will not stand by and allow North Vietnam to be bombed into rubble. I have hardly been an optimist on this war, but it is turning even nastier than I thought it would—and faster.